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August 18, 2004

To: Supervisor Don Knabe, Chairman
Supervisor Gloria Molina
Supervisor Yvonne B. Burke
Supervisor Zev Yaroslavsky
Supervisor Michael D. Antonovich

From: J. Tyler McCauley 
Auditor-Controller

Subject: **FISCAL REVIEW OF SECURE TRANSITIONS, INC. - A FOSTER
FAMILY AGENCY CONTRACTOR**

Attached is our audit report on Secure Transitions, Inc. (Secure Transitions or Agency) fiscal operations for the period of January 1, 2002 through December 31, 2002. Secure Transitions is licensed to operate a Foster Family Agency (FFA) and for the period of our review had 115 children placed by Los Angeles County in approximately 33 certified homes. During the period of our review, the Agency received \$1,201,932 in FFA funds from the Department of Children and Family Services (DCFS) and paid \$496,800 of the FFA funds directly to foster parents. Secure Transitions is located in the Second District.

Scope

The purpose of our review was to determine whether Secure Transitions has complied with its contract terms and appropriately accounted for and spent foster care funds on allowable and reasonable expenditures in providing services to children placed in the Agency's care. We also evaluated the adequacy of Secure Transitions' accounting records, internal controls and compliance with applicable federal, State and County fiscal guidelines governing the disbursement of FFA foster care funds.

Summary of Findings

We identified \$17,471 in expenditures that were either not supported, inadequately supported by original invoices and receipts, or were unallowable. We also noted areas in which Secure Transitions did not fully comply with the terms of its contract. Specifically, Secure Transitions did not name the County as an additional insured on its

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General Liability insurance policy as required under its contract with the County. As a result, the County incurred approximately \$211,000 in legal costs defending itself in a case involving an injury to a foster child. We have recommended that DCFS and County Counsel evaluate the possibility of recovering these legal costs from the Agency. We also noted instances where there is a need to strengthen internal controls. These areas include disbursement and accounting procedures, payroll expenditures and bank reconciliations.

We have recommended that DCFS resolve these identified expenditures and, if appropriate, collect all disallowed amounts. In addition, DCFS must ensure that Secure Transitions management takes the appropriate corrective actions to address the recommendations in this report and monitor to ensure that the corrective actions taken result in permanent changes.

Review of Report

We discussed our report with Secure Transitions management on August 3, 2004. Secure Transitions management has agreed to provide DCFS with a written response and corrective action plan within 30 days. In addition, DCFS has agreed to provide the Board with a written response within 60 days, outlining the resolution of all findings and questioned costs contained in this report.

If you have any questions, please contact me, or your staff may contact DeWitt Roberts at (626) 293-1101.

JTM:DR:MM
Attachment

c: Chief Administrative Office
David E. Janssen, Chief Administrative Officer
Claudine Crank, Budget & Operations Management Branch
Raymond G. Fortner Jr., Chief Deputy County Counsel
Department of Children and Family Services
David B. Sanders, Ph.D., Director
Angela Carter, Deputy Director, Bureau of Administration
Joan Smith, Deputy Director, Bureau of Finance
Edward Sosa, Interim Division Chief, Quality Assurance Division
Secure Transitions, Inc.
Melvin M. Moore, Ph.D., Executive Director
Board of Directors
California Department of Social Services
Cora Dixon, Bureau Chief, Foster Care Audits Bureau
Sheliah Dupuy, Bureau Chief, Foster Care Rates Bureau
Violet Varona-Lukens, Board of Supervisors Executive Office
Public Information Office
Audit Committee Members
Commission for Children and Families

SECURE TRANSITIONS, INC.
FISCAL AUDIT OF FOSTER FAMILY AGENCY CONTRACT

BACKGROUND

The Department of Children and Family Services (DCFS) contracts with Secure Transitions, Inc. (Secure Transitions or Agency) to recruit, certify, train and support foster family homes, and to provide treatment and support services for DCFS children placed in these homes. For the period of our review, January 1, 2002 through December 31, 2002, the Agency had 115 children placed by Los Angeles County in approximately 33 certified homes. Secure Transitions is located in the Second District.

Under the provisions of the contract, DCFS pays Secure Transitions a monthly rate based on the Foster Family Agency (FFA) Treatment Notification Letter provided by the California Department of Social Services (CDSS). During our review, the Agency received a monthly rate between \$1,589 and \$1,865 per foster child. For our review period, the Agency received \$1,201,932 in foster care funds from DCFS.

CDSS has also established minimum amounts that Secure Transitions is required to pay certified foster parents. Secure Transitions is required to pay the foster parents between \$624 and \$790 per month in accordance with the CDSS minimum rate criteria. During the period of our review, Secure Transitions paid out approximately \$496,800 to foster parents.

APPLICABLE REGULATIONS AND GUIDELINES

Secure Transitions is required to operate its FFA in accordance with certain federal, State and County regulations and guidelines. We referred to the following applicable regulations and guidelines during our audit:

- FFA Contract, including Exhibit D, DCFS Contract Accounting and Administration Handbook (DCFS Handbook).
- Federal Office of Management and Budget Circular A-122, Cost Principles for Non-Profit Organizations (Circular).
- California Department of Social Services Manual of Policies and Procedures (CDSS MPP).
- California Code of Regulations, Title 22 (Title 22).

REVIEW OF EXPENDITURES

Our review disclosed a total of \$17,471 in questioned costs. Details of these costs are discussed below.

Unsupported/Inadequately Supported Costs

The DCFS Handbook states that all revenues and expenditures shall be supported by original vouchers, invoices, receipts, timecards, travel logs, contract and loan agreements and/or other documentation and that unsupported expenditures shall be disallowed upon audit.

Secure Transitions did not have adequate documentation to support foster care expenditures totaling \$11,967. Specifically we noted:

- \$6,381 in inadequately supported payroll expenditures. The personnel files of three of the Agency's employees contained no documentation of the authorized rate of pay for the employee. In another instance, the authorized salary on file in the personnel file was significantly less than the salary paid to the employee.
- \$5,586 in unsupported and inadequately supported expenditures for items such as advertising, employee reimbursements, cell phone bills, pagers, adjustments for petty cash disbursements, adjustments to the Agency's bank account, purchases from a restaurant, and purchases from various stores such as Target, Everything is Silver, Best Buy, Bath & Body, Robinsons-May, Albertson's grocery store and Jewelry Plaza. Also included in this amount is the monthly payment on one of the Agency's credit cards since neither the credit card statement for June 2002, nor any other supporting documentation for the month could be located.

The Agency was either unable to provide any supporting documentation such as itemized receipts to indicate what was actually purchased, or provided inadequate supporting documentation to substantiate the expenditures.

Unallowable Costs

We identified \$5,504 in unallowable FFA expenditures. This amount consists of \$5,255 in credit card finance charges and \$249 in late payment fees, which are not allowable according to the Circular. Of the total, the majority of the finance charges were related to three lines of credit that the Agency has with Wells Fargo Bank and a Platinum Plus credit card account, which had balances of \$27,308, \$4,144, \$1,909 and \$6,994, respectively as of December 31, 2002. During the audit period, the assessment of finance charges was the only activity on one of the lines of credit and the credit card account. On the other two lines of credit, there were only nominal purchases, with a large portion of the overall activity being the assessment of finance charges.

Secure Transitions management should develop a plan to reduce its debt and minimize the Agency's finance charges. This plan should be submitted to DCFS, who should monitor the plan to ensure that it is implemented and FFA funds are not used to pay the Agency's finance charges. In addition, DCFS should determine if the Agency, prior to our audit period, used FFA funds to pay finance charges. If so, DCFS should take action to collect those amounts.

Recommendations

Secure Transitions management:

- 1. Consistently maintain adequate supporting documentation for all foster care expenditures, including original itemized receipts.**
- 2. Develop a plan to reduce its debt and minimize the Agency's finance charges.**

DCFS management:

- 3. Resolve the \$17,471 in questioned costs and, if appropriate, collect any disallowed amounts.**
- 4. Monitor the implementation of Secure Transitions debt reduction plan and ensure that the Agency does not continue to pay finance charges on credit accounts with FFA funds.**
- 5. Determine if the Agency used FFA funds to pay finance charges prior to the audit period and take action to collect any amounts identified.**

CONTRACT COMPLIANCE AND INTERNAL CONTROLS

Our review disclosed several contract compliance issues and internal control weaknesses in addition to those already mentioned. DCFS should ensure that Secure Transitions management takes appropriate corrective actions to address each of the internal control recommendations in this report. DCFS should also monitor the Agency to ensure that these corrective actions result in permanent changes.

Compliance with Insurance Requirements

In July 2000, a foster child who Secure Transitions was responsible for was injured. As a result of this incident, both Secure Transitions and the County were sued by the injured child's natural mother acting as Guardian ad Litem. The plaintiff alleged in her complaint that the County was liable for the injury because it negligently failed to adequately supervise and investigate the foster parents. Secure Transitions did not name the County as an additional insured on its General Liability insurance policy as is required under Section 21.3 of its contract with the County. In addition, Secure

Transitions' insurer invoked an exclusion under the General Liability policy, contending that the child was injured as the result of an assault and battery. For these reasons, on June 5, 2001, Secure Transitions' insurance company denied coverage to the County that would have provided the County with legal representation to defend against the lawsuit. The plaintiff did not file her first complaint until July 5, 2001. The allegations against Secure Transitions were the same as those against the County.

Since Secure Transitions' insurer denied the County coverage, the County had to engage outside counsel to represent it in the lawsuit. Although there was ultimately no judgment against the County in this action, the County paid approximately \$211,000 to outside counsel for attorneys fees, expert witness fees and deposition costs.

With respect to the decision of Secure Transitions' insurer to deny coverage to the County, in part, on the basis that an uninsurable assault and battery was the cause of the child's injury, there were no allegations that any employee of Secure Transitions directly injured the child. Therefore, there is reason to believe that Secure Transitions, and thus the County, under the "additional insured" coverage, would have been entitled to be defended under the policy against claims based on other than direct assault of the child. The post trial report suggests that Secure Transitions' liability, if any, would arise from negligence rather than from assault and battery.

Since the County incurred substantial legal costs as a result of a breach of contract/unfair business practices by Secure Transitions, the possibility of recovery of the County's legal costs from Secure Transitions should be analyzed and, if viable, promptly pursued by DCFS and County Counsel. Statute of limitations considerations require that this be determined promptly. DCFS and County Counsel should also assess the possibility of a bad faith claim against Secure Transitions' insurer.

Recommendation

- 6. DCFS and County Counsel analyze and pursue promptly, if appropriate, recovery of the legal costs incurred by the County as a result of Secure Transitions' breach of contract/unfair business practices, including assessing the possibility of a bad faith claim against Secure Transitions' insurer.**

Accounting Procedures

We reviewed Secure Transitions' accounting procedures and noted the following:

- The DCFS Handbook states that cash receipts (i.e., cash or checks) totaling \$500 or more shall be deposited within one day of receipt. We reviewed Secure Transitions' timeliness of depositing DCFS payments and noted several instances where the Agency made deposits for amounts over \$500 up to 28 days after the check issue date. The Agency needs to take steps to ensure that County payments are deposited timely. Many FFAs that contract with the County have their County

payments direct deposited. To ensure timely deposits and increase security over payments, Secure Transitions should consider direct deposits to improve the timeliness of its County payment deposits, which will also improve the Agency's cash flow.

- Certain transactions were miscoded in the Agency's general ledger. For example, a mileage payment made to an Agency employee was coded to "Contracts Expense", payments for internet expenses were sometimes coded to "Meetings/Trainings", and a late payment fee was coded to "Office Furniture & Equipment". Secure Transitions management should ensure that its accounting records accurately reflect the financial transactions of the Agency.

Recommendations

Secure Transitions management:

- 7. Ensure cash receipts totaling \$500 or more are deposited within one day of receipt.**
- 8. Ensure transactions are properly classified in the general ledger.**

Disbursement Procedures

Our review disclosed the following weaknesses in the Agency's disbursement procedures:

- The Agency does not consistently write or stamp "Paid" on vendor invoices. Only 34 of 45 items reviewed were appropriately cancelled. In addition, the cancelled checks were not referenced to the supporting documentation. To prevent duplicate payments and facilitate the identification of supporting documents, all invoices should be cancelled upon payment and referenced to cancelled checks.
- The Agency does not have a policy requiring two signatures for larger dollar disbursements. To ensure that disbursements are appropriate, the Agency should establish a written policy requiring two signatures on checks issued above a specified amount (e.g., \$500).

Without proper disbursement controls in place, there is increased risk that Secure Transitions management will not be able to ensure that FFA funds are spent on reasonable and allowable expenditures.

Recommendations

Secure Transitions management:

9. Ensure cash receipts totaling \$500, or more are deposited within one day of receipt.
10. Ensure all vendor invoices and receipts are appropriately cancelled and referenced to check numbers upon payment.
11. Establish a written policy to require two signatures on checks issued for larger dollar disbursements.

Payroll Controls

CDSS MPP Section 11-402 requires that supporting documentation be maintained for all program expenditures, including salary rates. We reviewed eleven employee personnel files and found that five of the files did not contain the employee's authorized salary rate, or pay history. Of the six personnel files that did contain authorized salary rates, five did not agree to the amount that the employee was paid, and in one instance, the salary rate included in the personnel file was significantly less than the amount actually paid. Without proper payroll and personal controls in place, the Agency cannot consistently ensure that payroll expenditures are authorized and accurate.

Recommendation

12. Secure Transitions management ensure personnel files contain authorized salary amounts or hourly rates of pay approved by management which agree with actual pay rates.

Bank Reconciliations

DCFS Handbook Section 4.011 states that monthly bank reconciliations should be prepared within 30 days of the bank statement date and reviewed by management for appropriateness and accuracy. Both the preparer and the reviewer should sign and date the bank reconciliations. Neither the preparer nor reviewer at Secure Transitions signs and dates its bank reconciliations. Therefore, we were unable to determine whether the bank reconciliations were prepared timely and reviewed for appropriateness and accuracy.

Recommendation

13. Secure Transitions management ensure the Agency's bank account reconciliations are signed and dated by both the preparer and the reviewer.